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No. 788

In the Supreme Court of the United States

October Term, 1963

Mary D. Agnew and Alice E. Agnew, petitioners

v.

Peter Dalleo et al., Constituting the Atlantic County Board of Chosen Freeholders, et al.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 159

EGON D. AREND AND MELA K. AREND, PETITIONERS

v.

PERRY DEMASTERS, INTERNAL REVENUE AGENT, INTERNAL REVENUE SERVICE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions, findings of fact, and conclusions of law of the district court (Pet. 19a–26a; R. 34–41, 43, 53–61) are not reported. The opinion of the court of appeals (Pet. 2a–18a) is reported at 313 F. 2d 79.

JURISDICTION

The judgment of the court of appeals was entered on January 24, 1963 (R. 150),[1] and a petition for rehearing was denied on February 26, 1963 (R. 151). The petition for a writ of certiorari was filed on May 24, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "R." refers to the Joint Appendix in the court of appeals.

QUESTION PRESENTED

Whether petitioners were entitled to an injunction against any further investigation by the Internal Revenue Service of their tax liability and against compliance by their bank with a Service summons.

STATUTES INVOLVED

Sections 7602 and 7605 of the Internal Revenue Code of 1954 provide in pertinent part:

> SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.
>
> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may

be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

SEC. 7605. TIME AND PLACE OF EXAMINATION.

* * * * * *

(b) *Restrictions on Examination of Taxpayer*—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

STATEMENT

Revenue Agent Perry A. DeMasters began an investigation in 1957 of petitioners' tax returns for the years 1940 through 1956. The investigation revealed that petitioners, upon their arrival in this country from Czechoslovakia in 1940, had a net worth of no more than $10,000 (R. 97); that, although their net worth had increased to approximately $150,000 by the end of 1956 (R. 97), they had reported income of only $43,000 during this period (Gov. Ex. H). Having discovered this unexplained increase in net worth of approximately $100,000, Agent DeMasters sought to determine whether the increase was attributable to unreported income which had been received in those years. An examination of the deposit slips

during 1948 of the Arend Shoe Company [2] account at the First National Bank in Portland, Oregon, revealed that a total of $92,659 had been deposited in 1948 (R. 102). The tax returns filed by petitioners in 1948 reported the gross business sales receipts of the Arend Shoe Company to be $74,968 (R. 102), thus indicating an apparent omission from gross income of over $17,000 for that year. In seeking further proof of unreported income to explain the increase in net worth, the Service issued a summons directed to the United States National Bank of Portland (R. 56). The summons directed the bank to produce for inspection by the Internal Revenue Service all records from 1940 to 1957 pertaining to the financial, loan, and investment activity of petitioners, their children, Richard and Inez Arend, and of the Arend Shoe Company (R. 57).

On August 18, 1958, petitioners instituted the present action to enjoin the Internal Revenue Service from examining any financial records belonging or relating to them for years prior to January 1955 (R. 10). The complaint further prayed that the United States National Bank of Portland be permanently enjoined from disclosing any information regarding transactions by or with petitioners during this same period (R. 10). The complaint alleged *inter alia* that the investigation of petitioner's tax returns for years prior to 1955 was barred, in the absence of fraud, by the statute of limitations; that there was no probable cause to suspect that any fraud existed with respect

[2] The Arend Shoe Company was formerly a sole proprietorship owned by petitioner Egon Arend (R. 57).

to those years; and that further investigation, either of their own records or those of the bank, was therefore precluded by both the Fourth Amendment and by Section 7605(b) of the Internal Revenue Code, *supra*, p. 3, which prohibits "unnecessary" examinations (R. 7–8).

The district court, after hearing the testimony of Agent DeMasters, concluded that the government did not have "reasonable grounds" or other "probable cause" to suspect the existence of fraud, and permanently enjoined the government from examining any records with respect to years prior to 1955 (Pet. 19a; R. 54, 59, 62–63). The court of appeals reversed, holding that the investigation was neither prohibited by the Fourth Amendment nor "unnecessary" within the meaning of Section 7605(b) (Pet. 6a–7a, 18a).

ARGUMENT

The Commissioner of Internal Revenue has commenced an investigation of petitioners' tax liability for the years 1940 through 1956. The investigation, up to this time, has consisted of examining the tax returns filed by petitioners, obtaining records which were voluntarily disclosed by different sources, and issuing a summons to the United States National Bank of Portland to produce its records relating to petitioners. In the absence of a finding of fraud, in which case the tax may be assessed at any time, the statutory period within which to assess additional taxes against petitioners has expired for all years prior to 1955 (R. 47). The Commissioner seeks by his investigation to determine if fraud exists.

Petitioners sought, and the district court issued, an injunction which restrained the Service from examining petitioners, any records of petitioners, or any third party with respect to any year before 1955 (R. 10, 62). The injunction also enjoined the bank from disclosing any information to the Service relating to a year before 1955 (R. 62–63). Petitioners argue that they are entitled to such an injunction under Section 7605(b) of the Code—which prohibits "unnecessary examination or investigations"—and the Fourth Amendment since the Service had insufficient evidence of fraud.

1. Petitioners are plainly not entitled to an injunction against the Service's investigation. A government agency may conduct an investigation, regardless of the amount of evidence it has, as long as it does not use compulsion. It is through such an investigation, which depends on voluntary cooperation with law enforcement authorities, that sufficient evidence is obtained to utilize compulsory process. Thus, the Fourth Amendment, which prohibits only "unreasonable searches and seizures," applies in terms only to certain kinds of government coercion. Section 7605(b) is likewise intended, as the legislative history shows (see *infra*, pp. 8–9), as protection against government harassment.

2. Petitioners are also not entitled to an injunction against the bank's voluntary decision to disclose information to the Service. As we have seen, Section 7605(b) and the Fourth Amendment apply only to compulsory disclosures. Therefore, petitioners' rights

to prevent disclosure by the bank depend exclusively on state law—whether state law prohibits a bank from voluntarily disclosing information relating to its clients to others. Since no such right under Oregon law has been shown, petitioners are not entitled to an injunction against any decision by the bank to cooperate voluntarily.

3. The third issue in this case is whether petitioners are entitled to an injunction against enforcement by the Service of the summons against the bank or compliance by the bank with it. On that issue, petitioners' contentions are also without merit.

a. First, petitioners have no standing to complain under either the Fourth Amendment or Section 7605 (b) concerning a summons which was directed to another party to produce records belonging to that party. It is well established that the Fourth Amendment may be invoked only by the person who is the victim of the search and seizure. *E.g., Goldstein* v. *United States*, 316 U.S. 114. Similarly, Section 7605 (b) is intended to protect against the harassment of repeated inquiries (see *infra*, p. 8). Except for the possible worry that the Service will uncover evidence of fraud, petitioners are in no way affected by a summons directed to their bank. Accord, *Application of Magnus*, 299 F. 2d 335 (C.A. 2).[3]

[3] *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731 (C.A. 9), is not in conflict with *Magnus* since *Martin* involved the resistance of a securities company to a summons directed to it. The company of course had standing since it was directly affected by the summons.

b. Second, Congress has provided a means of challenging an allegedly illegal summons by refusing to obey it and then defending that refusal in a criminal prosecution or enforcement action under Sections 7210 and 7604 of the Code. The government submits that these provisions were intended to be exclusive and that therefore neither an action to enjoin enforcement of the summons nor to quash it may be maintained. While the Second Circuit has suggested the contrary in *Application of Colton*, 291 F. 2d 487, this was on the ground that Section 7210 subjected the recipient of a summons to criminal prosecution for disobedience of it even before the enforcement proceeding.[4] But here the summons was directed to the bank and not to petitioners; consequently, they cannot possibly be subjected to criminal prosecution prior to the enforcement proceeding.

c. Third, on the merits, the court of appeals, after carefully analyzing both the legislative history of Section 7605(b) and the case law interpreting it, held (Pet. 11a–12a):

> * * * Congress was primarily concerned with protecting taxpayers from examinations which were "unnecessary" in the sense that they followed prior investigations of the same matter which had established that there was no basis for liability. As the Court of Appeals for the Second Circuit has said, "The stricture

[4] In *Colton*, the government argued that the motion to quash was barred by sovereign immunity; it did not argue that Sections 7210 and 7604 were exclusive. However, in rejecting the government's contention, the court of appeals discussed these two sections and indicated that they were not exclusive.

> against 'unnecessary' examinations was designed to prevent uselessly repetitive procedures and investigations not relevant to possible tax liability, not to nullify the preceding sections of the Code." *Application of the United States*, 246 F. 2d 762, 765 (1957); 60 Mich. L. Rev. 187, 204–05 (1961).

The court therefore held that the government need establish only that "the decision to investigate * * * was in fact reached as a matter of rational judgment based on the circumstances of the particular case * * *" (Pet. 17a).

This interpretation of the statute is in harmony with the Congressional grant of broad powers to the Commissioner for the purpose of determining a taxpayer's correct tax liability. See Section 7602 of the Internal Revenue Code, *supra*, pp. 2–3. It is also consistent with the doctrine that administrative agencies may "investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." *United States* v. *Morton Salt Co.*, 338 U.S. 632, 642–643. Accord, *Civil Aeronautics Board* v. *Hermann*, 353 U.S. 322; *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 214–216. There is no reason why the Internal Revenue Service should be held to a stricter standard.

Petitioners contend (Pet. 10-14) that the standard applied by the court of appeals under Section 7605(b) is inconsistent with that laid down by other circuits.[5] Whether or not this is true, none of those

[5] The court below appears to consider the rules in other circuits to be unclear (Pet. 13a, note 28).

cases are relevant here. All involved the power of a court to order the taxpayer to comply with a summons issued by the Service. Here, however, the Service merely started an investigation and issued a summons directed to a third party, petitioners' bank. No enforcement proceeding has been started.

Even if, contrary to our arguments above (pp. 7–8), taxpayers may rely on Section 7605(b) when the summons is directed to another party and an action to enjoin the Service from enforcing a summons may be maintained prior to the enforcement proceeding, we submit that the Service, at the least, need only show that it acted rationally in issuing the summons. For the harm to the taxpayers if the summons turns out to be defective is slight if any; they themselves are not harassed even if the summons is ultimately enforced and, furthermore, they can raise their objections in the enforcement proceeding. In short, we believe that, even if the Service must show probable cause to compel enforcement of the summons against its recipient, it need not do so to defend against an injunction action brought by taxpayers who did not receive the summons. No court of appeals has held to the contrary.

The government's evidence in the district court was amply sufficient to meet the test required by the court below under Section 7605(b)—that the decision to issue the summons be based on a rational judgment concerning the circumstances of the particular case. Indeed, we submit that the information of the Service meets the probable cause standard advocated by petitioners. The Service had information that peti-

tioners, upon their arrival in this country in 1940, had a minimal net worth; that as of 1956 their net worth had increased by an amount substantially exceeding the income reported on their returns during this period; and that in the year 1948 alone there was an unexplained omission from gross income of over $17,000 (see the Statement, *supra*, pp. 3–4). While it may well be that the increases in net worth are attributable to non-taxable sources of income, as petitioners contend (Pet. 19–20), it is clear that the Service had probable cause. Whether the accretions can be otherwise explained can be ultimately resolved only after there has been a more thorough investigation which may necessitate use of compulsory process.

The Fourth Amendment, like Section 7605(b), does not require probable cause to issue a summons to produce records. This Court has held that the test to be applied under the Fourth Amendment for a subpoena *duces tecum*, which is essentially the same as a summons to produce documents, is markedly different from the standard applicable to warrants. In *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 209, the Court said that "[t]he requirement of 'probable cause, supported by oath or affirmation,' literally applicable in the case of a warrant, is satisfied in that of an order for production by the court's determination that the investigation is authorized by Congress, is for a purpose Congress can order, and the documents sought are relevant to the inquiry."

Section 7602, *supra*, pp. 2–3, authorized the issuance of a summons to obtain records relevant to an inquiry

into tax liability. The records of petitioners' bank for the tax years being investigated were relevant to the investigation, particularly since the Service had information that petitioners had a large and unexplained increase in net worth during the relevant years. And there can be no doubt that Congress could constitutionally compel a bank to disclose records relevant to a tax investigation.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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PETITIONERS' REPLY BRIEF

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OCTOBER TERM, 1963

No. 159

EGON D. AREND and MELA K. AREND,
Petitioners,

v.

PERRY DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON),
Respondents.

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No. 159

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONERS' REPLY BRIEF

1. The Government's principal argument in opposition to certiorari is that this suit for an injunction to prevent Internal Revenue officials from violating the Constitution (the Fourth Amendment) and a statute (26 U. S. C. § 7605(b)) does not properly lie within the jurisdiction of the District Court (Govt. Br. pp. 7-8). This argument, however, is contrary to the decision of the Court below (R. 138-139). In addition, it presents the same question which

this Court has been asked to decide in *Reisman* v. *Caplin*, 317 F. 2d 123 (D. C. Cir. 1963), *cert. granted*, 31 U. S. L. Week 3416 (June 17, 1963). Indeed, the decision of the Court below in the present case was the key decision relied upon in the *Reisman* petition for certiorari as establishing a conflict among the circuits on this question.

In both Courts below, the Government premised this argument, among other things, on the sovereign immunity doctrine and on the provision in 26 U. S. C. § 7604 concerning enforcement of IRS summonses.

The District Court rejected this contention, stating:

> "Although the Courts are hesitant to interfere with other branches of the Government, still it is hornbook law that the courts can prevent unconstitutional and arbitrary harrassment of citizens by agents of the administrative agencies, or prevent such agents from acting in excess of their authority as established by law, and the agents of the Bureau of Internal Revenue are no exception. See 28 Am. Jur., Injunctions, §§ 170-181." (R. 37).

After quoting 28 U. S. C. § 1340, the District Court added:

> "Although most of the cases which come before the courts are those wherein there is a refusal to comply with a summons to produce records, [by] either the taxpayers or a third party who has records concerning the taxpayer's business, still there is nothing to prevent the taxpayer from taking the initiative and preventing the Commissioner from investigating, especially when the third party notifies the taxpayer that it will comply with the order issued by the defendants to produce records concerning the taxpayer's banking business. The situation does arise by reason of the use of the revenue statute on the part of defendants, and, hence, this is a '* * * civil action arising under * * * [an] Act of Congress

providing for internal revenue * * *' and as such is within the jurisdiction of the Court" (R. 37).

The Court of Appeals agreed with the District Court that "the action fell within the jurisdictional grant of Section 1340" (R. 139). It further ruled:

> "Section 1340 is not a consent by the United States to suits against it. However, if appellants were indeed prohibited by Section 7605(b) or the Fourth Amendment from the initiation of this inquiry, a suit to restrain their unlawful conduct would not be barred by the doctrine of sovereign immunity" (*Ibid.*).

These rulings are well-supported. *E.g., Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U. S. 579 (1952), affirming 103 F. Supp. 569 (D. D. C.).*

The Government's Brief (p. 8) does note that its argument is contrary to the Second Circuit decision in *Application of Colton*, 291 F. 2d 487 (2d Cir. 1961).

Curiously, however, the Government omits to cite the only Court of Appeals decision supporting its argument—namely, that of the Court of Appeals for the District of Columbia Circuit in *Reisman* v. *Caplin*, 317 F. 2d 123 (D. C. Cir. 1963). That decision is soon to be reviewed by this Court pursuant to a writ of certiorari granted on June 17, 1963 (31 U. S. L. Week 3416)—the main argument for certiorari there being that the decision of the District of Columbia Circuit Court of Appeals "is in direct conflict

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* Recently, the Government made the same unsuccessful argument with respect to a motion to quash an IRS summons: "We rejected the Government's contention that this Court had no jurisdiction to quash an internal revenue summons, as being an unconsented to suit against the United States . . . ." *Application of Howard*, 210 F. Supp. 301, 302 (W. D. Pa. 1962).

with" the present decision (Petition for Certiorari p. 5, *Reisman* v. *Caplin*, Oct. Term 1962, No. 1084).*

In *Reisman*, the District of Columbia Circuit Court held that an action to restrain the Commissioner of Internal Revenue from enforcing a subpoena to third persons under the color of 26 U. S. C. § 7602, but actually in violation of the Fourth Amendment, was beyond the District Court's jurisdiction. The Court there said that "it is not within the court's jurisdiction because it is in substance a suit against the United States to which it has not consented" (317 F. 2d at 125).**

We respectfully submit that the conflict among the circuits on this significant question is a further reason for granting certiorari. And we respectfully request that the Court grant certiorari and set this case down for argument jointly with *Reisman* v. *Caplin*.

2. The Government does not dispute that there is a conflict among the circuits on the proper standard to be applied under 26 U. S. C. § 7605(b) where the IRS seeks to investigate tax years barred by the statute of limitations absent fraud.

---

*The *Reisman* Petition for Certiorari further noted:

> "The jurisdictional facts relied on by the respective plaintiffs in the *Arend*, *Colton* and *Reisman* cases . . . are identical. In all three cases the contention is that the respective Respondents, the individual Special Agent [DeMasters] or the Commissioners directing the Special Agent [Respondent Caplin] in whose very name the subpoenaes were issued (J. A. p. 19), acted unlawfully and beyond their respective Statutory authority" (*Id.* pp. 6-7) (material in brackets in original).

**In its brief in opposition to certiorari in *Reisman*, the Government stated: "The court of appeals held that petitioners' action was barred by sovereign immunity. This holding admittedly raises questions of some difficulty" (Govt. Br. p. 6, *Reisman* v. *Caplin*, Oct. Term 1962, No. 1084). In a footnote to this, the Government added:

> "The Ninth Circuit in *DeMasters* v. *Arena*, 313 F. 2d 79 (Pet. 17a-33a), has suggested in dictum that sovereign immunity does not apply to suits where the taxpayer alleges that the summons was without statutory authorization or was unconstitutional" (*Id.* p. 6 n. 2).

The Government does seem to argue that the cases which reject "the standard adopted by the court of appeals under Section 7605(b)," are not applicable because those cases involve enforcement proceedings. (Govt. Br., pp. 9-10). However, the Government never explains—as it cannot—why the proper standard under Section 7605(b) should be any different in an enforcement proceeding (or a proceeding to quash a summons) than in an action for an injunction to restrain violation of that statute.

The Court below made no such distinction. Indeed, it ruled that the command contained in Section 7605(b) is "unequivocal" (R. 141) and "constitutes a limitation on the power of the tax collecting authorities" (*Ibid.*). The scope of that limitation is the same whether it is raised in an enforcement proceeding: a motion to quash or an action for an injunction.

And we submit that the only proper standard under Section 7605(b)—where the IRS seeks to investigate years closed absent fraud—is whether "there is probable cause or reasonable basis for it to believe that in those years the taxpayer perpetuated a fraud upon the revenue." *O'Connor v. O'Connell*, 253 F. 2d 365, 369 (1st Cir. 1958); *Wall v. Mitchell*, 287 F. 2d 31 (4th Cir. 1961); *U. S. Aluminum Siding Corp. v. Eshleman*, 170 F. Supp. 12 (N. D. Ill. 1958); *McDermott v. John Baumgarth Co.*, 286 F. 2d 864 (7th Cir. 1961).

Moreover, in stating that no Court of Appeals has held this standard to be applicable in an injunction action against the IRS, the Government obviously overlooks *Zimmerman v. Wilson*, 105 F. 2d 583 (3d Cir. 1939), affirming 25 F. Supp. 75 (E. D. Pa. 1938), discussed in our Petition (p. 12).

3. The Government asserts that "petitioners are also not entitled to an injunction against the bank's voluntary decision to disclose information to the Service" (Govt. Br.

p. 6). This assertion is without merit in this case. For one thing, we are here concerned with disclosure pursuant to compulsion of a summons—not voluntary disclosure (*e.g.*, R. 59). Moreover, as noted in our Petition (p. 21), the bank did not respond to the summons and did not appear in this action or contest petitioners' request for the injunction.

4. The Government does not contend that it has shown probable cause to suspect fraud. It does assert that its evidence in the District Court was sufficient to meet the test adopted by the Court of Appeals under § 7605(b) (Govt. Br. p. 10). However, this "evidence" consists solely of "figures" and "estimates" that entered the agent's head (R. 111). And the Government still has not shown how its decision to proceed can be deemed to have been reached as a matter of "rational judgment" (Govt. Br. p. 10) when —as the District Court expressly found—it was not and is not based on "any . . . proper cause" (R. 59).

Respectfully submitted.

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